

THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

AMENDATORY SECTION: (Amending WSR 86-18-069, filed 9/3/86)

WAC 458-20-251 Sewerage collection ((business)) and other related activities. (((1))

Introduction. Under the provisions of chapter 471, Laws of 1985, the "sewerage collection business" was reclassified for tax purposes from the service classification of business and occupation tax to the public service business—sewer collection classification of public utility tax. To implement this change in law the department of revenue amended and adopted WAC 458-20-179, on November 1, 1985, which subjected gross receipts from all sewerage services to the higher rated public utility tax classification, as of the effective date of chapter 471, Laws of 1985, July 1, 1985.

(2) The department has determined that, within the intent of the law, only the portion of gross receipts from customer billings attributable to the "collection" portion of services rendered should be taxed under the public utility tax classification. Thus, this section now supersedes and effectively repeals the specific provisions of WAC 458-20-179 pertaining to sewerage collection businesses. The provisions of this new section have retroactive effect from July 1, 1985 forward.

(3) Definitions. For purposes of this section the following terms will apply.

(a) "Sewerage collection business" means the activity of receiving sewage deposited into and carried off by a system of sewers, drains, and pipes to a common point, or points, for disposal or for transfer to treatment for disposal, but does not include such transfer, treatment, or disposal of sewage.

(i) This term does not include the activity of receiving, collecting, or disposing of toxic or hazardous waste materials regardless of the system employed for collection of such substances.

(b) "Sewage" means the waste matter carried off by sewer drains and pipes.

(c) "Gross receipts" of the sewerage collection business means only that portion of income from customer billings which is allocable to the collection of sewage by a sewerage collection business as defined herein.

(i) "Gross receipts," as defined here, is the public utility tax measure. It does not include any charges of any kind attributable to sewerage services other than collection.

(ii) The term does not include late charges or penalties which may be imposed for nontimely payment by customers.

(d) "Person" has the meaning given in RCW 82.04.030 or any later, superseding section.

(4) Persons engaged in the sewerage collection business may also be engaged in related business activities involving the interception, transfer, storage, treatment, and/or disposal of sewage, or any of these activities. If so, such persons are engaged in both public utility taxable activities (sewerage collection) and business and occupation taxable activities (other sewer services). See RCW 82.16.060 and 82.04.310.

(5) Public utility tax. Persons engaged in the sewerage collection business, as defined herein, are subject to the public utility tax under the classification, sewer collection, measured by "gross receipts" of the collection business as explicitly defined herein, at the currently prescribed rate. (See RCW 82.16.020 (1)(a).)

(6) In order to determine the "gross receipts" of the collection business there are two alternative methods.

THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

(a) If customer billings are itemized to show the actual charge for sewerage "collection," that amount is the "gross receipts" tax measure. Provided, That such amount shall not be less than the actual cost of providing the collection service.

(b) If collection services are provided jointly with other, related sewer services provided by the sewerage collection business or any other person, and the actual charge for sewerage "collection" is not itemized on customer billings, a simple cost of doing business formula must be used to derive the "gross receipts," public utility tax measure.

(i) The totality of all business costs incurred in rendering all sewer services, including collection, is to be divided into the costs of providing sewerage collection services. The resulting percentage is to be multiplied by gross income from customer billings (all sewerage related charges). The result is the "gross receipts" public utility tax measure from engaging in the sewerage collection business.

(ii) The formula looks like this:

$$\begin{array}{lcl} \text{Sewerage collection} & & \text{Public} \\ \text{costs} & & \text{Utility} \\ \text{(Annualized)} & = & \\ \text{Total sewer service} & = \% \times \text{gross} & = \text{Tax} \\ \text{costs} & \text{billing} & \text{Measure} \\ \text{(Annualized)} & & \end{array}$$

(iii) All costs of operation of the sewer services business must be included in the denominator, including but not limited to capitalized equipment, labor, direct and indirect overhead, and administration.

(iv) The standard cost accounting records of the sewerage collection business will be used for this purpose.

(v) For the purpose of annualizing its costs, the sewerage collection business may use the previous calendar year costs or its budget allocations for the current tax year. In either case, however, it must make an end-of-year adjustment to its reporting based upon actual costs incurred during the current year.

(7) Business and occupation tax. Persons engaged in providing other sewer services, in addition to or separate from the "sewerage collection business" as defined herein, are subject to the business and occupation tax under the classification, service and other business activities. The measure of this tax is the gross income derived from such other services. It does not include any amount reported for public utility tax under the sewer collection classification.

(8) The service business and occupation tax on sewer services is not intended to have a pyramiding effect. RCW 82.04.432 thus provides a deduction from the tax measure for amounts paid by municipal sewerage utilities and other public corporations to any other municipal corporation or governmental agency for sewage interception, treatment, or disposal. This deduction results in each one of several sewer service providers being taxable only on the amounts actually received and retained by them as their respective share of gross customer billings for the totality of all services.

(9) Under the law, depending upon the arrangement for providing the totality of all sewer services, it may be that a person will report tax under both the public utility tax (on collection services income) and business and occupation tax (on other related services income), as appropriate, upon respective portions of that person's retained share of income from customer billings.

THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

(10) The "sewerage collection business" and many other sewer services are "enterprise activities" as defined in WAC 458-20-189, when funded over fifty percent by user fees. Thus, the amounts derived from these business activities are not exempt of tax even though they may be provided and charged for by governmental entities. (See RCW 82.04.419.)

(11) Persons engaged in providing sewer services other than sewerage collection, such as the transfer, storage, treatment, and/or disposal of sewage, may be entitled to certain express deductions or exemptions from business and occupation tax for specific reasons unrelated to the nature of their sewer service activities. (See RCW 82.04.419 and 82.04.4291.) These deductions and exemptions are not available for "sewerage collection businesses" upon their income subject to public utility tax.

(12) Retail sales tax. Persons engaged in the "sewerage collection business" and/or engaged in providing other related sewer services are themselves the consumers of all tangible personal property purchased for their own use in conducting such activities, other than items held for resale in the ordinary course of business. Retail sales tax must be paid to materials suppliers and providers of all such tangible consumables. (See RCW 82.04.050.)

(13) Use tax. The use tax is due upon all tangible personal property used as consumers by "sewerage collection businesses" and sewer service providers, upon which the retail sales tax has not been paid. (See RCW 82.12.020.)

(14) Retroactivity procedures for refund. Because of the provisions of WAC 458-20-179 relating to sewer services, which were effective from July 1, 1985 and have been retroactively repealed, some persons providing sewer services after that date may have overreported their tax liability. Any such persons who reported and paid public utility tax measured by gross customer billings income or measured by income allocable to the transfer, treatment, and/or disposal of sewage are entitled to a refund or credit. Such refunds or credits will be in the amount of the difference between the public utility tax rate (.03852) and the service business tax rate (.015) on the income reported. The refund or credit may be obtained by timely providing amended copies of past reporting documents to the Taxpayer Accounts Administration Section of the Department of Revenue, Olympia, Washington. (See RCW 82.32.170.) Similarly, persons who have discontinued reporting tax liability on income from any sewer services, on or after July 1, 1985, will have additional tax liability to report.)

(1) **Introduction.** RCW 82.16.020 levies a public utility tax upon persons engaging in the business of sewerage collection. This rule provides guidance on the assessment of the public utility tax upon sewerage collection businesses, including the distinction between sewerage collection and other related business activities. It also describes how to determine the taxable gross receipts of a sewerage collection business that also engages in other related business activities. Additionally, the rule addresses a sewerage collection business's business and occupation (B&O), retail sales, and use tax reporting responsibilities. Municipalities and other governmental entities engaging in sewerage collection business activities should also refer to WAC 458-20-189 for guidance on the taxation of public service businesses and enterprise activities.

(2) **What is a sewerage collection business?** A sewerage collection business is the activity of accepting sewage to be deposited into and carried off by a system of lateral sewers, drains, and pipes to a common point, or points, for transfer to treatment or disposal, but does not include the actual transfer, treatment, or disposal of sewage. A sewerage collection business includes only that portion of a sewer system where "collection" occurs. Sewerage collection ends when the sewage exits the lateral sewers in a

THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

sewer system. Collection does not include the further transfer of sewage through a system of intercepting sewers or the final treatment or disposal of sewage.

(a) **What is the difference between sewage and sewerage?** Sewage is the waste matter carried off by sewer drains and pipes. Sewerage refers to the physical facilities (e.g. pipes, lift stations, and treatment and disposal facilities) through which sewage flows.

(b) **What is the difference between lateral and intercepting sewers?** A lateral sewer is a branch sewer running laterally down a street, alley, or easement that collects sewage directly from abutting properties and delivers it into an intercepting sewer. A lateral sewer is normally eight inches or less in diameter. An intercepting sewer is a main sewer that receives its flow primarily from laterals and delivers the sewage to another main sewer or to a point for treatment or disposal. An intercepting sewer is normally greater than eight inches in diameter.

(c) **How are drainage utility charges accounted for?** Certain real estate development projects (due to paving and other factors) may adversely affect rainwater runoff within areas served by a stormwater sewer system. Often, the stormwater system is administered by the same entity that operates a sewerage collection business. In this circumstance, some sewerage utilities impose a drainage utility charge on the development to reflect the impact on the utility's stormwater sewer system caused by the increased runoff. Other sewerage utilities charge all sewerage customers an additional drainage utility charge to reflect stormwater runoff. Although the same entity may be providing both stormwater and sanitary sewer collection services to the customer and many of the same facilities may be used, a drainage utility charge is not related to the collection of sewage for treatment and disposal. Therefore, a sewerage collection business does not include this activity. Utility drainage charges are, however, subject to B&O taxation under the service and other activities classification, as discussed in subsection (4) below.

(3) **How is the public utility tax determined?** Persons engaged in the sewerage collection business are subject to the public utility tax under the sewer collection classification measured by the gross receipts of the collection business. (See RCW 82.16.020.) Gross receipts of the sewerage collection business include only that portion of income from customer billings that is allocable to the collection of sewage by a sewerage collection business. Gross receipts do not include any charges of any kind attributable to sewerage services other than collection.

There are two methods to determine the gross receipts of the collection business.

(a) **Itemization of customer billings.** If customer billings are itemized to show the actual charge for sewage collection, income realized from those billings is the gross receipts tax measure. If the itemized charges for sewage collection are less than the actual cost of providing the collection service, however, the sewerage collection business must use the cost-of-doing-business formula in subsection (3)(b) below.

(b) **Cost-of-doing-business formula.** If collection services are provided jointly with other, related sewer services provided by the sewerage collection business or any other person, and the actual charge for sewerage collection is not itemized separately on customer billings or is less than the actual cost of providing the collection service, a simple cost-of-doing-business formula is used to derive the gross receipts public utility tax measure.

(i) **Formula.** All business costs incurred in rendering all sewer services, including sewerage collection, are divided into the costs of providing sewerage collection services. The resulting percentage is multiplied by gross income from customer billings (all sewerage related charges). The result is the gross

THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

receipts public utility tax measure from engaging in the sewerage collection business. The standard cost accounting records of the sewerage collection business must be used for this purpose.

The formula is:

$$\frac{\text{Sewage collection costs (Annualized)}}{\text{Total sewer service costs (Annualized)}} = \frac{\text{Public Utility Tax Measure}}{\text{gross billing income}}$$

In determining sewerage collection costs for a sewerage collection business that also engages in related business activities involving the interception, transfer, storage, treatment, and/or disposal of sewage, only lateral sewers are considered collection sewers. Intercepting sewers are not collection sewers and may not be allocated to collection activities. All costs of operation of the sewer services business must be included in the denominator, including but not limited to, direct operating costs and direct and indirect overhead costs.

(ii) **Annual year-end adjustment.** For the purpose of annualizing its costs, the sewerage collection business may use the previous calendar year costs or its budget allocations for the current tax year. In either case, however, it must make an end-of-year adjustment to its reporting based upon actual costs incurred during the current year.

(c) **Late charges/penalties excluded.** Late charges or other penalties for untimely payment by sewerage collection customers must be excluded when calculating gross receipts under subsections (3)(a) and (b) above. Receipts from these sources are subject to B&O taxation under the service and other activities classification as provided in subsection (4) below. (See WAC 458-20-179, Public utility tax, for further explanation of the taxation of late charge penalties.)

(4) **How are related business activities taxed?** Persons engaged in the sewerage collection business may also be engaged in related business activities involving the interception, transfer, storage, treatment, and/or disposal of sewage. These activities are generally subject to the service and other activities B&O tax. The measure of tax is the gross income or gross proceeds derived from those other services. The measure of tax does not include any amount subject to the sewerage collection public utility tax classification. The amount of gross income or gross proceeds subject to the service and other activities B&O tax must be determined consistent with the method used to determine the gross receipts subject to the sewerage collection public utility tax (see subsection (3) above).

(5) **What if a governmental sewerage collection business pays a separate governmental entity for sewage interception, treatment or disposal?** RCW 82.04.432 provides a deduction from the B&O tax measure for amounts paid by municipal sewerage utilities and other public corporations to any other municipal corporation or governmental agency for sewage interception, treatment, or disposal. Thus, in such cases the service and other activities B&O tax on sewer services does not have a pyramiding effect. In addition, RCW 82.04.4291 provides a B&O tax deduction for amounts derived by a political subdivision of the state of Washington from another political subdivision of the state of Washington as compensation for services subject to the service and other activities B&O tax. Income received from the state of Washington or its agencies and departments, however, is not deductible under RCW 82.04.4291. Thus, the local government

THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

entity that receives compensation from another local government entity for providing sewage interception, treatment, or disposal for that other government entity may also deduct the income from its own measure of service and other activities B&O tax, provided this amount has been included in the gross amount reported on the Combined Excise Tax Return. In such a case, neither entity pays tax on the amounts represented by the payments made for sewage interception, treatment, or disposal.

For example, Washington Municipality A operates a sewerage collection business. Rather than invest in its own treatment facilities, it contracts with Washington Municipality B to provide sewage transfer, treatment, and disposal services to Municipality A. When determining its tax liability, Municipality A must break down its sewage service charges (as provided in subsection (3) above) into a sewerage collection portion and that portion representing other sewage services (transfer, treatment, and disposal). Municipality A pays public utility tax on its gross receipts from the sewerage collection business. Municipality A also pays service and other activities B&O tax on income derived from that portion of sewage transfer that it undertakes to move the waste to Municipality B for further transfer, treatment, and disposal by Municipality B. However, Municipality A may deduct from its gross income subject to service and other activities B&O tax the amount of any payments made to Municipality B for sewage interception, treatment, or disposal services provided by Municipality B. In addition, pursuant to RCW 82.04.4291, Municipality B may deduct from its gross income subject to service and other activities B&O tax the amount of the payments received from Municipality A.

(6) **Property purchased and used by a sewerage collection business.** Persons engaged in the sewerage collection business and/or engaged in providing other related sewer services are themselves the consumers of all tangible personal property purchased for their own use in conducting those activities. Retail sales tax (commonly referred to as “deferred sales tax”) or use tax must be remitted directly to the department upon all tangible personal property used by a sewerage collection business or sewer service provider as a consumer, if the retail sales tax has not been collected by the seller. (See RCW 82.12.020.)

(7) **Sale of sludge.** With proper treatment, it is possible for the sludge remaining after the initial treatment of raw sewage to be used as fertilizer. If a sewerage collection business sells sludge, manufacturing B&O tax is due on the value of the products and retailing or wholesaling B&O tax is due on the gross proceeds of the sale. A multiple activities tax credit (MATC) applies as provided in RCW 82.04.440 and WAC 458-20-19301. If the sludge is sold to a consumer, retail sales tax is due on the proceeds of that sale, unless otherwise exempt by law.

If the necessary requirements are met, the business may claim a manufacturing machinery and equipment (M&E) exemption for machinery and equipment used directly in manufacturing the sludge (rendering it suitable for use as a fertilizer). This exemption is not available for machinery or equipment used merely to treat sewage for disposal. See RCW 82.08.02565, 82.12.02565, and WAC 458-20-13601.